

**INDEPENDENT AUDITORS' REPORT**

To the Director and Inspector General of the  
Federal Emergency Management Agency

We have audited the accompanying consolidated balance sheet of the Federal Emergency Management Agency (FEMA), the combined balance sheet of its Directorates and Administrations, and the balance sheet of the Disaster Relief Fund (DRF), each as of September 30, 1999, and the related statements of net cost, changes in net position, budgetary resources, and financing for the year then ended, collectively referred to as the financial statements. These financial statements are the responsibility of the management of FEMA. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements appearing on pages 95 through 121 of this report present fairly, in all material respects, the financial position of FEMA, its Directorates and Administrations and the DRF as of September 30, 1999, and their net costs, changes in net position, budgetary resources and reconciliation of net cost to budgetary obligations for the year then ended, in conformity with generally accepted accounting principles.

The supplemental combining balance sheets and related statements of net costs and changes in net position of the FEMA Directorates and Administrations appearing on pages 123 through 129 of this report are presented for the purpose of additional analysis of the combined financial statements of the Directorates and Administrations rather than to present the financial position, net cost and changes in net position of the individual Directorates and Administrations, and are not a required part of the basic combined financial statements. These supplemental combining statements have been subjected to the auditing procedures applied in our audit of the basic 1999 combined financial statements of the Directorates and Administrations and, in our opinion, are

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fairly stated in all material respects when considered in relation to the combined financial statements taken as a whole.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08 as amended, we have also issued our report dated February 18, 2000, on our consideration of FEMA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche LLP*

February 18, 2000

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND COMPLIANCE BASED UPON THE AUDIT PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Director and the Inspector General of the  
Federal Emergency Management Agency

We have audited the financial statements of the Federal Emergency Management Agency (FEMA), its Directorates and Administrations and the Disaster Relief Fund (DRF), as of and for the year ended September 30, 1999, and have issued our report thereon dated February 18, 2000. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered FEMA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect FEMA's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Reportable conditions noted are described in the following paragraphs and include significant departures from certain requirements of OMB Circular A – 127, *Financial Management Systems*, which incorporates by reference Circulars A – 123, *Management Accountability and Control*, and A – 130, *Management of Federal Information Resources*, among other requirements. We believe that the following reportable conditions are also material weaknesses.

1. As defined in OMB Circular A – 127, “a financial management system encompasses automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.” Such financial management systems shall be designed to provide for effective and efficient interrelationship between software, hardware, personnel, procedures, controls, and data contained within the systems. These integrated systems shall have the following characteristics: (1) common data elements; (2) common transaction processing; (3) consistent internal control over data entry, transaction processing and reporting; and (4) efficient transaction entry.

With respect to system requirements in the area of financial reporting, OMB Circular A – 127 requires that an “agency financial management system shall be able to provide financial information in a timely and useful fashion to (1) support management’s fiduciary role; (2) support the legal, regulatory and other special management requirements of the agency; (3) support budget formulation and execution functions; (4) support fiscal management of program delivery and program decision making; (5) comply with internal and external reporting requirements, including, as necessary, the requirements for financial statements prepared in accordance with the form and content prescribed by OMB and reporting requirements prescribed by Treasury; and (6) monitor the financial management system to ensure integrity of financial data.”

Also, OMB Circular A – 123 requires that management controls be in place to ensure that “laws and regulations are followed” and “reliable and timely information is obtained, maintained, reported and used for decision – making.”

During our audit of FEMA’s financial statements, we identified deficiencies related to the internal control over the preparation, analysis, and monitoring of financial information to support the efficient and effective preparation of agency wide financial statements. Because of the deficiencies noted, we believe that FEMA’s financial management system does not yet share the third characteristic of an integrated system as noted above, with respect to “consistent internal control over data entry, transaction processing and reporting.” We also believe that FEMA is not in full compliance with the system design requirements identified at numbers 5 and 6 above, sufficient “in a timely and useful fashion,” to “comply with internal and external reporting requirements, including ... the requirements for financial statements prepared in accordance with the form and content prescribed by OMB and reporting requirements prescribed by Treasury” and to “monitor the financial management system to ensure integrity of financial data.”

We recognize that FEMA continues to undertake significant efforts to fully implement the reporting requirements of OMB Bulletin No. 97 – 01, *Form and Content of Agency Financial Statements*. In 1999 a new layer of one-year appropriations and new reporting elements have placed substantial new reporting demands on existing resources. While we believe FEMA has made significant progress toward meeting its planned reporting objectives, significant improvements are still required as the processes and infrastructure that support the preparation of the agency’s consolidated financial statements are not yet stable nor subject to appropriate levels of supervision and review. For example, we noted that:

- ◇ Overall, FEMA did not perform timely cash reconciliations on all Fund Balance with Treasury accounts throughout 1999. Furthermore, FEMA did not provide a timely year – end reconciliation that was complete and accurate and that tied to the financial statements.
  - FEMA did not resolve differences found during the cash reconciliations in a timely manner. For example, the Statement of Differences for November 1998 still had an unresolved difference of \$8.9 million as of June 30, 1999 – seven months later.
  - FEMA’s year-end cash reconciliation showed unresolved differences of \$4.2 million. FEMA estimated that \$3 million of this amount represented carryover from prior fiscal years.
  - FEMA made several corrections to the Department of Treasury’s cash records for the Disaster Relief Fund in error.
- ◇ FEMA reported a \$285 million adjustment in the Disaster Relief Fund without fully researching the accounting and reporting issues surrounding it. FEMA did not notify or seek concurrence for the accounting treatment from the Office of Inspector General before reporting this large adjustment. As a result, the resolution of this issue was delayed.
- ◇ FEMA was not able to provide a logical and specific timetable for publishing the financial statements and accompanying information with sufficient time built - in to allow proper review by management and the Office of Inspector General, nor for the completion of substantive audit procedures.
- ◇ The number of separate funds that are included in the financial statements increased from 47 in 1998 to 60 in 1999. Reporting of the additional funds required additional efforts and management reviews that FEMA’s manual processes had difficulty accommodating in a timely manner. Specifically, the closing of the general ledger was delayed compared with prior years, causing FEMA to miss important milestone dates for the preparation of the year - end financial reporting information, including the trial balances and draft financial statements. Furthermore, additional adjustments had to be posted to the trial balances to correct or add data, which further delayed the production of accurate trial balances and demonstrated the increased risk of error.
- ◇ During 1999, FEMA began conducting interim closings of the general ledger and preparing “trial balances and other supporting information needed for external reports and financial statements” consistent with the core financial system requirements for federal agencies. Specifically, FEMA performed a close of the general ledger through six months, but reported limited success in producing financial statements. FEMA’s close of the general ledger through nine months produced incomplete statements. For these statements, FEMA decided not to include any balances from the prior year appropriations, and it did not allocate expenses associated with support organizations and prior year appropriations. Property, plant and equipment purchases and depreciation were not recorded.

As discussed in the "Framework for Federal Financial Management Systems" issued by the Joint Financial Management Improvement Program (JFMIP), an agency's financial management system should include "the ability to ... facilitate the preparation of financial statements, and other financial reports in accordance with federal accounting and reporting standards." The responsibilities of agency level data stewardship exist at each level within the agency to insure that "the information contained within the systems is accurate, timely, consistent and useful." In the reporting level architecture "reporting needs to be of proper scope, level of detail, timing, content, and presentation format to provide information of real value to users. The transaction classification structure of the event level architecture and summary information classification structure and reporting structure of the reporting level architecture work together to provide the necessary description of financial events to ensure the integrity of financial and related information collected and reported."

While FEMA's initial steps in implementing interim closings were important, the interim reporting process needs to mature into a routine and controlled process in order to be fully functional. In order to provide the timely and useful information to assess FEMA's data stewardship at the agency level and to facilitate reliable year – end reporting, we believe that the interim closing process should include the preparation of consolidated financial statements.

- ◇ Changes in the year – end financial statements resulting from errors or omissions required significant effort to correct because of the software used to produce the statements. This software is not integrated with FEMA's accounting system and requires significant manual data entry. As a result, the statement preparation process requires extensive review efforts, especially given the 60 funds that were inputted in 1999. While using an integrated software package for statement preparation is not required, non-integrated software significantly limits flexibility and turnaround times for statement production and increases the risk of errors. In 1999, the slower turnaround time impacted the timely production of corrected financial statements for our audit purposes.

Many of the observations noted above, especially those associated with the cash reconciliation process, resulted from the lack of sufficient staff and the need for more management oversight and review. Procedures for appropriate and timely account reconciliations and management reviews should be formalized to achieve proper internal control. Also, management needs to ensure better planning and follow - through for the financial statement preparation process in order for this process to be smoother and more timely.

2. We noted internal control deficiencies in certain aspects of FEMA's automated Integrated Financial Management Information System (IFMIS), particularly in the areas of access controls and program change controls. These deficiencies, in our view, indicate that computer – based controls do not contribute to the reliability of the accounting systems, taken as a whole.

We believe that FEMA continues to lack a fully implemented and documented system of management controls that meets the requirements of OMB Circular A – 123 and that supports the management structures that help ensure that “transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports.

We believe that management should finalize its draft information security policy for the automated system application and processing environment (scheduled for April 1, 2000). We also recommend that management complete its plan to establish roles and responsibilities for the development contractors of IFMIS and complete its plan for establishing FEMA's in – house capabilities to ensure appropriate approval, reporting and documentation of system modifications (in process).

Finally, with respect to the internal control related to performance measures reported in Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such control.

### **Compliance**

As part of obtaining reasonable assurance about whether FEMA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 98-08, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin 98-08, and are described below.

1. The material weaknesses in internal control over financial reporting discussed above indicate that FEMA is not in full compliance with the requirements of OMB Circulars A – 123 and A – 127.
2. We believe that FEMA does not substantially comply with the requirements of the FFMIA. Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with Federal financial management systems requirements, Federal accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance and evaluative criteria issued by OMB. As noted in FFMIA, “compliance with the financial management systems requirements of FFMIA applies to all financial management systems essential to meeting financial statement preparation and budgetary reporting requirements.”

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We found weaknesses in the design and operation of internal controls over financial reporting as discussed above, particularly with respect to the lack of a routine, fully matured process in support of the preparation, analysis, and review of the agency – wide financial statements.

We believe these weaknesses, in the aggregate, result in significant departures from certain of the requirements of OMB Circulars A – 123 and A – 127, and are therefore instances of substantial noncompliance with the Federal financial management systems requirements under FFMIA.

#### **Distribution**

This report is intended solely for the information and use of the management of the Federal Emergency Management Agency, the Inspector General for FEMA, the Office of Management and Budget, the U. S. General Accounting Office, and the U. S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLP*

February 18, 2000







# Federal Emergency Management Agency

Washington, D.C. 20472

FEB 28 2000

MEMORANDUM FOR: George J. Opfer  
Inspector General

FROM: Gary D. Johnson  
Chief Financial Officer

SUBJECT: Response to the Inspector General's Report

We are responding to the Inspector General's report on internal controls and compliance in conjunction with the FY 1999 financial statement audit, consistent with guidance from the Office of Management and Budget. FEMA agrees that there are deficiencies related to the internal control over the preparation, analysis, and monitoring of financial information to support the efficient and effective preparation of agencywide financial statements. However, we do not agree that these findings constitute substantial noncompliance with FFMIA.

As the auditor's report indicates, FEMA has made progress in correcting the conditions reported in this area. We believe we have reached a level to be in substantial compliance. We will continue to work with the Office of Inspector General to resolve identified deficiencies.

